



# The FY2011 Federal Budget

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## Summary

While considering the FY2011 budget, Congress faces very large budget deficits, rising costs of entitlement programs, and significant spending on overseas military operations. In FY2008 and FY2009, the enactment of financial intervention and fiscal stimulus legislation helped to bolster the economy, though it increased the deficit. While GDP growth has returned in recent quarters, unemployment remains elevated and government spending on “automatic stabilizer” programs, such as unemployment insurance and income support, remains higher than historical averages.

Between FY2000 and FY2009, federal spending has accounted for approximately 20% of the economy (GDP) and federal revenues averaged 18% of GDP. In FY2009, the U.S. government collected \$2.1 trillion in revenue (15% of GDP) and spent almost \$3.5 trillion (25% of GDP). Between FY2008 and FY2009, outlays increased by \$535 billion, while revenues fell by \$419 billion. The deficit in FY2009 was \$1,414 billion, or 9.9% of GDP, sharply higher than deficits in recent years.

The current economic climate poses a challenge to policymakers shaping the federal budget. Numerous actions taken by the federal government in FY2008 and FY2009 have had major effects on the budget, including two major economic stimulus measures and a variety of programs within the Federal Reserve, Treasury, and Federal Deposit Insurance Corporation (FDIC). The impact of this legislation, along with any additional legislation enacted, will influence deficit levels in FY2010 and beyond. The final costs of federal responses to this turmoil will depend on the pace of economic recovery, how well firms with federal credit guarantees weather future financial shocks, and government losses or gains on its asset purchases.

While many economists concur on the need for short-term fiscal stimulus despite adverse impact on the deficit, concerns remain about the federal government’s long-term fiscal situation. Rising costs of federal health care programs and baby boomer retirements present further challenges to fiscal stability. Operating these programs in their current form may pass substantial economic burdens to future generations.

The Obama Administration released its FY2011 budget on February 1, 2010. Congress began its consideration of the FY2011 budget after receiving the President’s budget request. The main policy initiatives emphasized in the President’s Budget include the creation of a fiscal commission tasked with improving the fiscal stability over the long term, other deficit-reduction proposals, ongoing economic recovery, and a continuation of health care reform, clean energy, and education initiatives.

This report provides an historical overview of the budget trends through the most recently completed fiscal year (2009). It discusses major budgetary challenges over the past several fiscal years given the current economic conditions and provides an in-depth discussion of the FY2011 budget process. Finally, it provides context for the issues facing the country’s federal budget over the long term. This report will be updated as events warrant.

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**T**he federal budget is central to Congress's ability to exercise its "power of the purse."<sup>1</sup> Federal budget decisions express Congress's priorities and reinforce Congress's influence on federal policies. Making budgetary decisions for the federal government is an enormously complex process and requires balancing competing goals.<sup>1</sup> Recent economic turmoil has strained the federal budget as a result of declining revenues and increasing spending levels. As recovery continues, the budget process will allow the President and Congress to negotiate and refine spending plans for the nation's fiscal priorities over the longer term.

The federal government faces very large budget deficits, rising costs of entitlement programs, and significant spending on overseas military operations. The enactment of financial intervention and fiscal stimulus legislation in FY2008 and FY2009 helped to bolster the economy, though it increased the fiscal burden. These federal interventions and policy responses, unprecedented in recent decades, helped stimulate economic activity and reduced dislocation in financial markets, but also exposed the federal government to substantial credit risks.

While GDP growth has returned in recent quarters, unemployment remains elevated and government spending on "automatic stabilizer" programs, such as unemployment insurance and income support, remains higher than historical averages.<sup>2</sup> This suggests that the recession's effects on the budget will likely linger for several more fiscal years.

In addition to the current challenges, concerns remain about the federal government's long-term fiscal situation. The rising costs of federal health care programs and the effects of the baby boom generation's retirement present serious challenges to future fiscal stability. Operating these programs in their current form may pass on substantial economic burdens to future generations, which may require significant government action and public sacrifice at levels greater than those needed to counteract the recent economic downturn.

## Overview

### Budget Cycle

A single year's budget cycle takes roughly three calendar years from initial formation by the Office of Management and Budget (OMB) until final audit.<sup>3</sup> The executive agencies begin the budget process by compiling detailed budget requests in the calendar year before the President's budget submission. Many agencies start working on their budgets during the spring and summer—about a year and a half before the fiscal year begins. OMB oversees the development of these agency requests. The President, by law, must submit a budget, which is based on OMB's work, by the first Monday in February.<sup>4</sup>

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<sup>1</sup> For more information, see CRS Report 98-721, *Introduction to the Federal Budget Process*, by Robert Keith.

<sup>2</sup> U.S. Department of Commerce, Bureau of Economic Analysis, "Gross Domestic Product: Fourth Quarter 2009 (Advanced Estimate)," press release BEA 10-02, January 29, 2010, available at [http://www.bea.gov/newsreleases/national/gdp/2010/txt/gdp4q09\\_adv.txt](http://www.bea.gov/newsreleases/national/gdp/2010/txt/gdp4q09_adv.txt).

<sup>3</sup> CRS Report 98-325, *The Federal Fiscal Year*, by Bill Heniff Jr.

<sup>4</sup> The contents of the Presidential budget submission are governed by U.S. Code, Title 31, Sec. 1105. Because the deadline for the President's budget follows inauguration so closely, budget submissions are often delayed during Presidential transition years. For more information, see CRS Report RS20752, *Submission of the President's Budget in Transition Years*, by Robert Keith.

Congress typically begins formal consideration of the budget resolution once the President submits his budget request. The budget resolution sets out a plan, agreed to by the House and Senate, that establishes the framework for subsequent budget legislation. Because the budget resolution is a concurrent resolution, it is not sent to the President for approval.

House and Senate Appropriations Committees and their subcommittees typically begin reporting discretionary spending bills after the budget resolution is agreed upon. Appropriations Committees review agency funding requests and propose levels of budget authority (BA). Appropriations acts passed by Congress set the amount of BA available for specific programs and activities. Authorizing committees, which control mandatory spending, and committees with jurisdiction over revenues also play important roles in budget decision making.

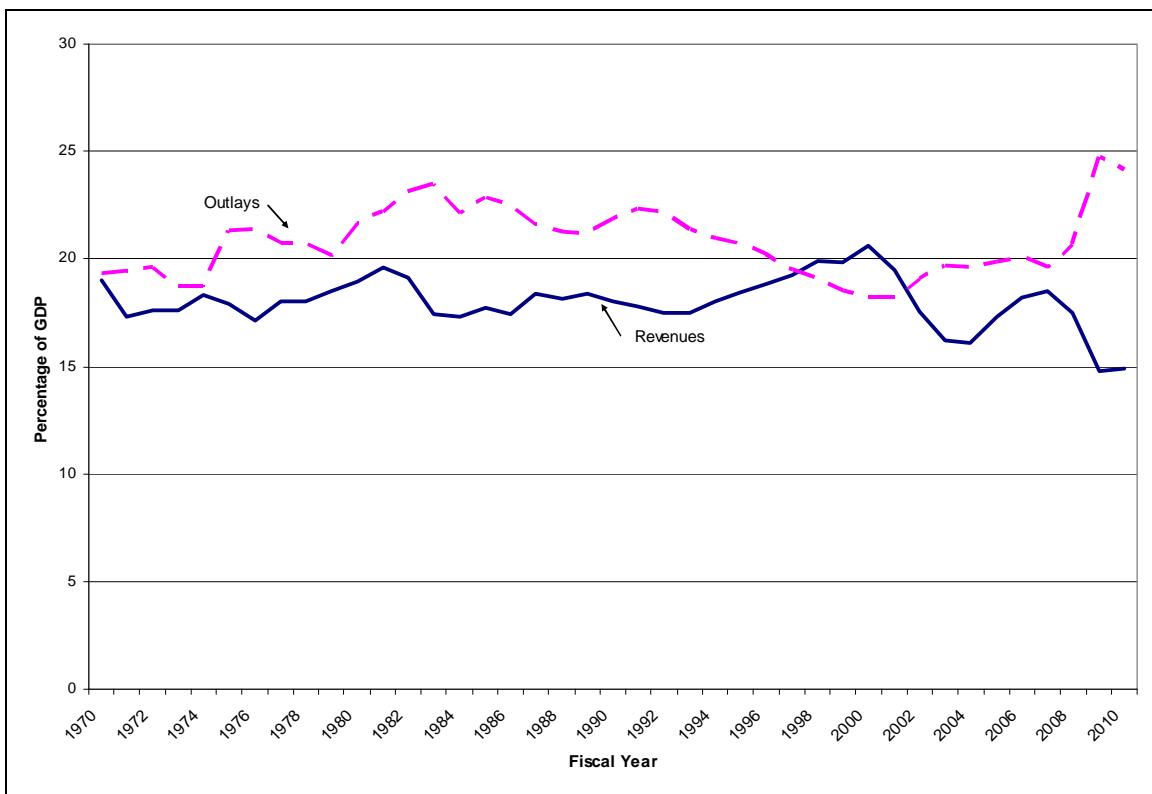
During the fiscal year, which begins on October 1, Congress and OMB oversee the execution of the budget. Once the fiscal year ends on the following September 30, the Treasury Department and the Government Accountability Office (GAO) begin year-end audits.

## **Revenues, Outlays, and Deficits for FY2009**

Between FY2000 and FY2009, federal spending has accounted for approximately 20% of the economy (as measured by gross domestic product—GDP) and federal revenues averaged 18% of GDP. In FY2009, the U.S. government collected \$2.1 trillion in revenue and spent almost \$3.5 trillion.<sup>5</sup> Between FY2008 and FY2009, outlays increased by \$535 billion while revenues fell by \$419 billion (in nominal terms), leading to the upward and downward spikes in outlays and revenues, respectively, shown in **Figure 1**.

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<sup>5</sup> U.S. Congressional Budget Office, *Historical Tables*, available at <http://www.cbo.gov/budget/historical.shtml>.

**Figure I. Total Outlays and Revenues as a Percentage of GDP, FY1970-FY2010**

**Source:** CBO, *Historical Tables*, available at <http://www.cbo.gov/budget/historical.shtml>; *Budget Projections*, available at <http://www.cbo.gov/budget/budproj.shtml>. Figures for FY2010 are estimated.

The annual differences between revenue (i.e., taxes and fees) that the government collects and outlays (i.e., spending) result in the budget deficit (or surplus).<sup>6</sup> The total deficit in FY2009 was \$1,414 billion, or 9.9% of gross domestic product (GDP), sharply higher than deficits in recent years. While large by historical standards, the FY2009 deficit was somewhat smaller than many analysts had originally forecasted at the start of FY2009 because several of the economic recovery programs, which, in practice, cost less than anticipated.<sup>7</sup>

The total deficit, according to some budget experts, gives an incomplete view of the government's fiscal condition because it includes Social Security surpluses (which are held in Treasury trust funds until used to pay future benefits).<sup>8</sup> Excluding off-budget items (Social Security benefits paid net of Social Security payroll taxes collected and the U.S. Postal Service's net balance) the (on-budget) FY2009 federal deficit was \$1,551 billion.

<sup>6</sup> Most economists use data on federal outlays to track larger budget trends, while most program analysts use budget authority to track changes in specific program areas.

<sup>7</sup> For further explanation of the changing costs of these programs, see the section of this report titled, "Changing Budgetary Impact of Major Financial Interventions and Economic Recovery Programs."

<sup>8</sup> Currently, the Social Security program collects more through the payroll tax than is needed to pay out current benefits, thus generating a surplus in the Social Security Trust Fund. By law, surplus dollars are required to be invested in non-marketable Treasury securities. From an overall budget perspective, these surpluses are used to offset other federal spending, thereby decreasing the current budget deficit while increasing the amount of Treasury securities held in the Trust Fund.

## Trends

### Federal Spending

Budget enforcement legislation divides federal outlays into discretionary and mandatory spending, as well as net interest.<sup>9</sup> Discretionary spending is controlled by annual congressional appropriations acts. Mandatory spending encompasses spending on entitlement programs and spending controlled by laws other than annual appropriation acts. Net interest comprises the government's interest payments on debt held by the public, offset by small amounts of interest income the government receives from certain loans and investments. Total outlays rose from 20.7% of GDP in FY2008 to 24.7% of GDP in FY2009.

Entitlement programs such as Social Security, Medicare, and Medicaid make up the bulk of mandatory spending.<sup>10</sup> Other mandatory spending programs include Temporary Assistance to Needy Families (TANF), Supplemental Security Income (SSI), unemployment insurance, veterans' benefits, federal employee retirement and disability, SNAP (formerly Food Stamps), and refundable tax credits, such as the Earned Income Tax Credit (EITC). Congress sets eligibility requirements and benefits for entitlement programs, rather than appropriating a fixed sum each year. Therefore, if the eligibility requirements are met for a specific mandatory program, outlays are made automatically.<sup>11</sup>

Over the past 40 years, mandatory spending has taken up a larger and larger share of the federal budget. In 1962, before the creation of Medicare and Medicaid, less than 30% of all federal spending was mandatory. At that time, Social Security accounted for about half of all mandatory spending. By FY2009, mandatory spending had grown to 60% of total outlays, with Social Security, Medicare, and the federal share of Medicaid alone comprising almost 41% of all federal spending.

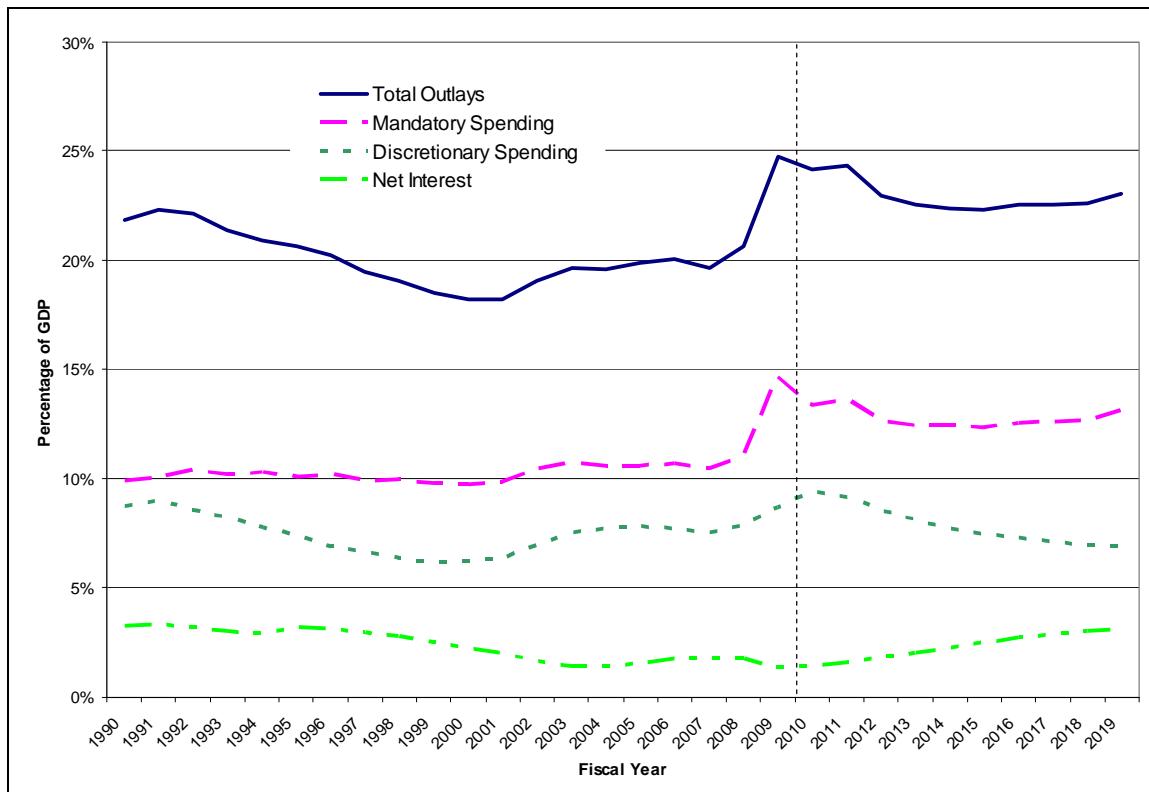
As **Figure 2** shows, mandatory spending, which equaled 11.0% of GDP in FY2008, totaled 14.7% of GDP in FY2009. TARP spending, costs linked to the federal conservatorship of mortgage giants Fannie Mae and Freddie Mac, and certain provisions of the American Recovery and Reinvestment Act of 2009 (ARRA), accounted for much of this increase in mandatory spending. Under current policy, CBO projects that FY2020 mandatory spending will total 13.3% of GDP, incorporating a return to economic stability but the beginning of long-term growth in entitlement spending.

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<sup>9</sup> For more information on trends in discretionary and mandatory spending, see CRS Report RL34424, *Trends in Discretionary Spending*, by D. Andrew Austin and Mindy R. Levit and CRS Report RL33074, *Mandatory Spending Since 1962*, by D. Andrew Austin and Mindy R. Levit.

<sup>10</sup> For more information see CRS Report RS20129, *Entitlements and Appropriated Entitlements in the Federal Budget Process*, by Bill Heniff Jr.

<sup>11</sup> Mandatory spending is controlled by established parameters for government commitments in permanent law, such as Social Security benefit levels and eligibility requirements. Once these laws have been established, mandatory funding for most programs must be included in annual appropriations bills as the appropriations committees must provide the budget authority needed to meet the commitment. Unlike discretionary spending, changes to mandatory funding levels can only be made through changes in the authorizing legislation.

**Figure 2. Outlays by Type as a Percentage of GDP, FY1990-FY2020**

**Source:** CBO, *Historical Tables*, available at <http://www.cbo.gov/budget/historical.shtml> and *Budget Projections*, January 2010, available at <http://www.cbo.gov/budget/budproj.shtml>. Data for FY2010 are estimates and data for FY2011-FY2020 are projections.

Discretionary spending as a share of GDP rose from 6.3% of GDP in FY2000 to 8.7% of GDP in FY2009 (see **Figure 2**), increasing 4.5% a year on average in real terms. The share of discretionary spending as a proportion of total federal outlays rose from 34.4% in FY2000 to 35.2% in FY2009. On average, from FY2000 to FY2009, defense discretionary outlays grew 5.3% per year in real terms, largely due to operations in Iraq and Afghanistan, while real non-defense discretionary outlays grew 3.6% per year.

By FY2020, according to CBO's baseline projections (which assume that discretionary spending remains constant in real terms), discretionary spending will fall to 6.7% of GDP, close to its levels in the late 1990s.<sup>12</sup> Net interest payments accounted for 1.3% of GDP in FY2009 and are estimated to rise to 3.2% of GDP in FY2020.<sup>13</sup>

Because discretionary spending represents slightly more than one-third of total federal outlays, some budget experts contend that any significant reductions in federal spending must include mandatory spending cuts. Other budget and social policy experts contend that cuts in mandatory spending would cause substantial disruption to many households because mandatory spending

<sup>12</sup> The assumption that discretionary spending will remain constant in real terms is at odds with the historical growth rate of discretionary spending, leading to projections which often underestimate discretionary spending levels. For more information, see the section titled "Budget Baseline Projections" later in this report.

<sup>13</sup> U.S. Congressional Budget Office, *Historical Tables*, available at <http://www.cbo.gov/budget/historical.shtml>.

funds important parts of the social safety net. Nevertheless, there is widespread agreement that action is needed to bring down anticipated high debt and deficit levels to restore long-term fiscal health.<sup>14</sup>

## Federal Revenue

Individual income taxes have long been the largest source of federal revenues, followed by social insurance (payroll) taxes. Federal individual and corporate income tax revenues typically track broader trends in the economy. In FY2008, individual income tax revenues totaled \$1,146 billion (7.9% of GDP), comprising about 45% of total federal revenues. In FY2009, difficult economic conditions and the tax relief provisions of ARRA led individual income tax revenue to fall to \$915 billion (6.4% of GDP). Corporate income tax revenues fell from \$304 billion in FY2008 to \$138 billion in FY2009. Federal revenues from other sources fell as well, although much less dramatically.<sup>15</sup> It is likely that revenues will remain depressed in FY2010. The longer-term revenue outlook depends on the speed of economic recovery and the legislative actions of Congress on certain expiring tax provisions and potential tax reform.<sup>16</sup>

## Deficits, Debt, and Interest

The federal government's fiscal stance is often gauged by the annual budget deficit. The budget deficit, however, may give a partial and potentially misleading picture of the government's long-term fiscal condition.<sup>17</sup> Annual budget deficits or surpluses determine, over time, the level of federal debt and affect the growth of interest payments to finance the debt.

### Federal Deficits

Differences between revenues and outlays determine whether or not the budget is in surplus or deficit. Occasional deficits, in and of themselves, are not necessarily problematic. Deficit spending can allow governments to smooth outlays and taxes to shield taxpayers and program beneficiaries from abrupt economic shocks in the short term. Persistent deficits, however, lead to growing levels of federal debt that may lead to higher interest payments, tax increases, or spending cuts, and may also have adverse macroeconomic consequences in the long term.<sup>18</sup>

Deficit projections for the next several fiscal years are high relative to historic standards. The deficit reached its peak in FY1943 at 30.3% of GDP. After WWII, deficits remained relatively low until the mid-1980s. In FY1985, the deficit reached 6.0% of GDP. The FY2009 total deficit was \$1,414 billion (9.9% of GDP), the largest in proportion to GDP since FY1945.<sup>19</sup>

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<sup>14</sup> In various reports, the Congressional Budget Office, the Government Accountability Office, and the Administration agree that the federal government's budget is on an unsustainable path. For more information, see the section of this report titled, "Long-Term Considerations."

<sup>15</sup> U.S. Congressional Budget Office, *Historical Tables*, available at <http://www.cbo.gov/budget/historical.shtml>.

<sup>16</sup> For more information, see CRS Report RL34425, *Expiration and Extension of the Individual Income Tax Cuts Enacted in 2001 Through 2008*, by Maxim Shvedov and CRS Report R40414, *Tax Reform: An Overview of Proposals in the 111<sup>th</sup> Congress*, by James M. Bickley.

<sup>17</sup> See CRS Report RL33623, *Long-Term Measures of Fiscal Imbalance*, by D. Andrew Austin.

<sup>18</sup> Committee for a Responsible Federal Budget, *Good Deficit / Bad Deficit*, April 2009.

<sup>19</sup> U.S. Office of Management and Budget, *Budget for Fiscal Year 2011, Historical Tables*, Table 1-3, available at (continued...)

## Federal Debt and Debt Limit

Gross federal debt is composed of debt held by the public and intragovernmental debt.<sup>20</sup> Intragovernmental debt is the amount owed by the federal government to other federal agencies, to be paid by the Department of the Treasury. This amount largely consists of money contained in trust funds, such as Social Security, that has been invested in federal securities as required by law.<sup>21</sup> Debt held by the public is the total amount the federal government has borrowed from the public and remains outstanding. This measure is generally considered to be the most relevant in macroeconomic terms because it is the debt sold in credit markets.

Changes in debt held by the public generally track the movements of the annual on-budget deficits and surpluses. Whether or not the movements of gross federal debt will follow those of debt held by the public depends on how intragovernmental debt changes.<sup>22</sup> Higher debt levels could slow investment and lower economic growth.<sup>23</sup>

Congress sets a ceiling on federal debt through a legislatively established limit that helps Congress assert its constitutional prerogative to control spending. The debt limit also imposes a form of fiscal accountability that compels Congress and the President to take visible action, in the form of a vote authorizing a debt limit increase, to allow further federal borrowing when nearing the statutory limit. The debt limit, however, can hinder the Treasury's ability to manage the federal government's finances when the amount of federal debt approaches this ceiling. In those instances, the Treasury has had to take unusual and extraordinary measures to meet federal obligations.<sup>24</sup> While the debt limit has never caused the federal government to default on its obligations, it has caused inconvenience and uncertainty in Treasury operations at times.

At the end of FY2009, federal debt subject to limit was approximately \$11,853 billion, of which \$7,544 billion was held by the public. CBO estimates that debt held by the public will reach \$8,797 billion at the end of FY2010, with debt subject to limit totaling \$13,260 billion.<sup>25</sup> The debt limit was most recently raised on February 12, 2010 (P.L. 111-139), and currently stands at \$14,294 billion.<sup>26</sup>

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<http://www.whitehouse.gov/omb/budget/fy2011/assets/hist.pdf>.

<sup>20</sup> Gross federal debt is also referred to as total debt or total public debt outstanding. Intragovernmental debt is also referred to as intragovernmental holdings or debt held by federal government accounts.

<sup>21</sup> U.S. Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2009, Analytical Perspectives*, Feb. 2008, p. 408.

<sup>22</sup> In FY2009, the increase in the deficit was larger than that of debt held by the public due to the nature of the obligations incurred as a result of the government conservatorship of Fannie Mae and Freddie Mac and the TARP program. For a larger discussion of why this occurred, see the section titled "Changing Budgetary Impact of Major Financial Interventions and Economic Recovery Programs" later in this report.

<sup>23</sup> For more information, see CRS Report RL34712, *Ebbs and Flows of Federal Debt*, by Mindy R. Levit.

<sup>24</sup> General Accountability Office, *Debt Ceiling: Analysis of Actions Taken During the 2003 Debt Issuance Suspension Period*, GAO-04-526, May 20, 2004.

<sup>25</sup> U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, Tables D-2, available at <http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf>.

<sup>26</sup> For further details, see CRS Report RL31967, *The Debt Limit: History and Recent Increases*, by D. Andrew Austin and Mindy R. Levit.

## Net Interest

In FY2009, the United States spent \$187 billion, or 1.3% of GDP, on net interest payments on the debt.<sup>27</sup> Since FY1970, the U.S. spent an average of 2.2% of GDP on interest payments. What the government pays in interest depends on market interest rates as well as on the size and composition of the federal debt. Currently, low interest rates have held net interest payments as a percentage of GDP below the historical average despite increases in borrowing to finance the deficit. Some economists, however, have expressed concern that federal interest costs could rise sharply once the economy recovers, resulting in future strain on the budget.<sup>28</sup>

## Budgeting in Tough Economic Times

The current economic climate poses another major challenge to policymakers shaping the federal budget. Numerous actions taken by the federal government in FY2008 and FY2009 have had major effects on the budget. Additional action currently under consideration could impact deficit levels further. Federal spending tied to means-tested social programs has also been increasing due to rising unemployment, while federal revenues have fallen as individuals' incomes drop and corporate profits sink.

## Federal Response to Economic and Financial Market Turmoil

The federal government has responded to financial turmoil with an extraordinary set of measures, including two major economic stimulus measures and a variety of programs within the Federal Reserve, Treasury, and Federal Deposit Insurance Corporation (FDIC). In February 2008, Congress enacted a \$152 billion package (P.L. 110-185, Economic Stimulus Act of 2008) to stimulate consumption by sending refunds to taxpayers and letting firms depreciate their capital more quickly.

Another effort to jump-start economic growth came in the form of a second stimulus package signed into law by President Obama on February 17, 2009. The American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5) included provisions that are now estimated to total \$862 billion in increased discretionary and mandatory spending and reduced tax revenue over the FY2009-FY2019 period.<sup>29</sup> ARRA contains support for state and local governments in the form of increased transportation project, Medicaid, and school funding, funding for health care information technology, extended unemployment benefits, as well as tax cuts and rebates among other provisions.<sup>30</sup>

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<sup>27</sup> U.S. Congressional Budget Office, *Historical Tables*, Tables F-5 and F-6, available at <http://www.cbo.gov/budget/historical.shtml>.

<sup>28</sup> Carmen M. Reinhart and Kenneth S. Rogoff, "The Aftermath of Financial Crises," *American Economic Review*, vol. 99 (2009), no. 2; Alan Auerbach and William Gale, "The Economic Crisis and the Fiscal Crisis: 2009 and Beyond," Tax Policy Center working paper, February 2009, available at [http://www.taxpolicycenter.org/UploadedPDF/411843\\_economic\\_crisis.pdf](http://www.taxpolicycenter.org/UploadedPDF/411843_economic_crisis.pdf).

<sup>29</sup> The original cost estimate for ARRA was increased by \$75 billion due to revised estimates of outlays for income security programs (unemployment insurance and SNAP program) and a higher participation rates in the Build America Bonds program. U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 2010, Appendix A, available at <http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf>.

<sup>30</sup> For more information on the provisions of ARRA, see CRS Report R40537, *American Recovery and Reinvestment* (continued...)

In addition to these stimulus efforts, various governmental bodies, through legislative and existing authority, engaged in numerous financial stability programs. The federal government placed government-sponsored enterprises Fannie Mae and Freddie Mac into conservatorship in September 2008, thereby gaining temporary authority to provide unlimited funds if necessary to help them remain solvent. In October 2008, Congress passed the Emergency Economic Stabilization Act of 2008 (EESA; P.L. 110-343), which authorized the Treasury Secretary to use \$700 billion (subject to certain congressional restrictions and notifications) to purchase troubled assets through the Troubled Assets Relief Program (TARP). As part of this program, Treasury purchased preferred shares from banks, assisted AIG and the domestic automakers, and provided other assistance to financial institutions. The Federal Reserve created a panoply of lending facilities, to provide financial institutions with loans in exchange for various types of collateral. The FDIC has used its standing authority to resolve failed banks and administer the federal guarantees on individual deposits, in addition to carrying out a broad guarantee program on debt issued by banks and supporting joint interventions in large banks.<sup>31</sup>

The size, variety, and complexity of federal responses to financial and economic turmoil present many challenges to budget analysis. The ultimate costs of these responses will depend on how the economy performs, how well firms with federal credit guarantees weather future financial shocks, and whether or not government funds are ultimately repaid. Estimating how much these responses will cost the federal government is difficult, both for conceptual and operational reasons. As a result, estimates of the costs of some of these programs have already changed significantly.

### **Changing Budgetary Impact of Major Financial Interventions and Economic Recovery Programs**

The distinction between outlays and budget authority is important to understanding the budgetary consequences of federal responses to economic and financial turmoil. Outlays are disbursed federal funds. Budget authority, as determined by what Congress appropriates, is what federal agencies can legally spend. Budget authority has been compared to funds deposited into a checking account, which then can be used for federal spending. Until the federal government disburses funds to make purchases, however, no outlays occur.

This distinction is especially important in understanding the impact of ARRA on the budget deficit over the next several fiscal years. The programmatic costs of ARRA consisted of roughly one-quarter revenue reduction measures and three-quarters increased outlays. Outlay measures can affect the budget deficit more slowly than revenue or transfer measures due to the time it takes between obligation of funds and actual spending (or outlays) on specific projects or programs. For example, if an individual receives extended unemployment benefits under the provisions of ARRA, the budgetary cost to the government would be incurred almost immediately upon the benefit being issued to the individual. However, if a state receives a grant to fund a transportation project, which may take five years to complete, the entire grant amount will be

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*Act of 2009 (P.L. 111-5): Summary and Legislative History*, by Clinton T. Brass et al.

<sup>31</sup> For further details on these actions, see CRS Report R41073, *Government Interventions in Response to Financial Turmoil*, by Baird Webel and Marc Labonte.

obligated immediately while the budgetary impact will be felt in each of the five years as outlays are made until the project is completed.<sup>32</sup>

Estimating the precise budgetary impact of programs like TARP and the government's conservatorship of Fannie Mae and Freddie Mac (also known as government sponsored enterprises or GSEs) is difficult for different reasons. Early amounts of TARP funds were used to purchase preferred equity stakes in major banks. EESA requires those equity purchases to be recorded in the budget in the year acquired on a net present value basis with an adjustment for market risk, so that the future sale of those equity stakes would offset much of the cost of acquiring them.<sup>33</sup> Over time, improved market conditions, lower estimates of the amount of TARP authority needed, and bank repurchases of stock sold to the government have decreased the impact of the program on the budget deficit. Other assets that have been acquired through TARP are treated similarly.

Differences also exist in the cost estimates of OMB and CBO due to the use of alternative assumptions and interpretations of budget concepts. OMB estimates TARP outlays on a net present value basis over the FY2009-FY2019 period at \$117 billion (excluding administrative costs and interest effects).<sup>34</sup> CBO estimates the value of these net present value outlays at \$99 billion (excluding administrative expenses) over the FY2009-FY2019 period.<sup>35</sup> The deficit impact of this program only tells part of the story. TARP purchases have had a different impact on the level of federal debt than they have had on the deficit. Though the impact of TARP on the deficit for the FY2009-FY2019 period is now estimated by CBO to be \$99 billion in net costs over the period, as discussed above, outlays by Treasury have been significantly greater than that. As of the end of FY2009, Treasury had disbursed \$365.1 billion.<sup>36</sup> In order to finance these outlays, the Treasury had to sell debt to the public. Taking this and other adjustments into account, the increase in federal debt held by the public exceeded the deficit in FY2009. However in FY2010, CBO estimates that the increase in the federal debt held by the public will be lower than the deficit.<sup>37</sup>

Estimating the cost of the aid given to the GSEs, in budgetary terms, is also complex. Unlike TARP, no legislation stipulated the precise methodology with which to use when accounting for the budgetary impact of these interventions. Prior to conservatorship, federally chartered Fannie Mae and Freddie Mac were considered non-governmental entities, which essentially meant that their balance sheets were not included in budget totals. Subsequent to the Treasury Secretary taking control of these entities through conservatorship, CBO determined that they were now part of the government and should be reflected in the federal budget. At that point, CBO began recording these costs on a net cash flow basis, similar to what is used to calculate TARP's budgetary impact. OMB, however, takes a different approach and records cash outlays to the

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<sup>32</sup> The budgetary impact of the Economic Stimulus Act of 2008 was different from ARRA's in that it was comparatively small and was composed, in large part, of stimulus checks sent to taxpayers. Because rebate checks were dispersed relatively quickly, the impact on the deficit from this legislation was largely incurred in FY2008.

<sup>33</sup> Mandated by Section 123 of the Emergency Economic Stabilization Act (P.L. 110-343).

<sup>34</sup> U.S. Office of Management and Budget, *Budget for Fiscal Year 2011, The Budget*, Table S-4.

<sup>35</sup> U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 2010, Box 1-2.

<sup>36</sup> U.S. Treasury, *Troubled Assets Relief Program Monthly 105(a) Report*—September 2009, October 9, 2009, p. 3, available at <http://financialstability.gov/latest/reportsanddocs.html>.

<sup>37</sup> U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 2010, Table 1-7.

GSEs in the budget but does not include any additional amount to account for market risk. These differences led to big discrepancies in budgetary impact since OMB only records liabilities as they occur, while CBO accounts for future shortfalls on these financial commitments now.

The differences between the accounting methodologies used by OMB and CBO lead to divergent effects on the budget. CBO recorded a subsidy cost of \$291 billion in FY2009. OMB placed the budgetary cost for the GSE intervention in FY2009 at \$95.6 billion in cash outlays. Over the FY2010-FY2019 period, OMB projects that cash outlays to the GSEs will total an additional \$65 billion. Over the same period, CBO projects a subsidy cost of \$99 billion.<sup>38</sup> OMB has faced criticism for its methodology as some argue that they do not account for the full budgetary cost of the program. Once the fiscal year ends, CBO uses the figures recorded by OMB.

## Budget Deficit Estimates for FY2010

The CBO baseline estimates the FY2010 budget deficit at \$1,349 billion or 9.2% of GDP, slightly lower than the FY2009 deficit of \$1,414 billion (9.9% of GDP).<sup>39</sup> The deficit is projected to be slightly lower than that of FY2009 due to an anticipated decline in federal aid to the financial sector, offset by increases in outlays from ARRA, income support programs, and net interest. Though revenues are expected to increase slightly, the slow pace of economic recovery will continue to hold receipts well below their historical average.

Under the President's Budget, deficit estimates for FY2010 amount to \$1,556 billion or 10.6% of GDP. This is larger than CBO's baseline deficit estimate due to differences in assumptions used as well as the inclusion of the impact of certain legislation not yet enacted. Some of these proposals include indexing the alternative minimum tax to inflation, the inclusion of a jobs initiatives and other temporary recovery measures, preventing a reduction in Medicare physician payments, tax cuts for families and businesses, and additional spending on overseas contingency operations.<sup>40</sup>

## FY2010 Supplemental Legislation

Supplemental appropriations complicate the budget process, specifically when it comes to comparing baseline budget forecasts due to the terms of budget enforcement conventions. CBO's baseline presumes that discretionary spending levels will continue as enacted for the following fiscal years in real (i.e., inflation adjusted) terms. If baseline projections are made before Congress enacts supplemental legislation, the baseline is likely to underestimate the likely cost of discretionary spending in future years. If the baseline projections are made after enactment of supplemental legislation and supplemental funding is lower in future years, then they could overstate the deficit estimates in future years. A measure to extend temporarily the period of eligibility for certain direct assistance benefits has already been enacted. Notable measures on war funding, job creation, and longer-term benefit extensions are now being considered by Congress.

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<sup>38</sup> For more information on these accounting methodologies, see U.S. Congressional Budget Office, *CBO's Budgetary Treatment of Fannie Mae and Freddie Mac*, January 2010, available at <http://www.cbo.gov/ftpdocs/108xx/doc10878/01-13-FannieFreddie.pdf> and U.S. Office of Management and Budget, *The Budget for Fiscal Year 2011, Analytical Perspectives*, pp. 346-358, available at <http://www.whitehouse.gov/omb/budget/fy2011/assets/topics.pdf>.

<sup>39</sup> U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 2010, Summary Table 1.

<sup>40</sup> U.S. Office of Management and Budget, *Budget for Fiscal Year 2011, The Budget*, Tables S-2 and S-7.

## War Funding<sup>41</sup>

Thus far, Congress has provided a total of \$138.6 billion in FY2010 funding for overseas contingency operations, including \$130 billion for the Defense Department, \$6.4 billion provided for the State Department's foreign and diplomatic operations, and \$2.1 billion for VA medical costs. As troop withdrawals in Iraq become more rapid and troop levels in Afghanistan remain the same, FY2010 funding represents a 7.8% decline from the FY2009 funding level of \$150.4 billion. However, with his budget, President Obama included a request for an additional \$33 billion in FY2010 supplemental funding for these operations.<sup>42</sup> If enacted, this would lead to a total FY2010 spending level greater than the FY2009 funding level.

## Hiring Incentives to Restore Employment Act and Other Measures

On December 16, 2009, the House passed the Jobs for Main Street Act (H.R. 2847), which would spend approximately \$154 billion on infrastructure investment, public service jobs, and emergency relief for families.<sup>43</sup> The Senate passed a scaled-down version of this legislation, titled Hiring Incentives to Restore Employment Act, on February 24, 2010, that would provide tax credits for hiring and retaining unemployed workers, extend a tax provision in ARRA related to expensing for small businesses, and reauthorize certain transportation authorities. On March 4, 2010, the House passed a modified version of the Senate bill, which is currently awaiting reconsideration in the Senate. Together, the spending and revenue measures in the modified bill would increase the deficit by \$4.5 billion in FY2010, but are projected to reduce the deficit by \$0.7 billion over the FY2010-FY2020 period.<sup>44</sup>

In subsequent legislation, the President signed the Temporary Extension Act of 2010 on March 2, 2010 (H.R. 4691, P.L. 111-144), which provided an extension of some direct assistance provisions including unemployment benefits and COBRA subsidies, along with an increase in Medicare payments to physicians and certain revenue raisers. Together, the spending and revenue measures in this law are estimated to increase the deficit by \$8.6 billion in FY2010, but are projected to reduce the deficit by \$13.6 billion over the FY2010-FY2020 period.<sup>45</sup> Congress is also considering additional extensions of the eligibility periods for these safety net programs and other provisions under the American Workers, State, and Business Relief Act of 2010 (H.R. 4213).

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<sup>41</sup> For more information, see CRS Report RL33110, *The Cost of Iraq, Afghanistan, and Other Global War on Terror Operations Since 9/11*, by Amy Belasco.

<sup>42</sup> U.S. Office of Management and Budget, *Budget for Fiscal Year 2011, The Budget*, p. 55.

<sup>43</sup> For more information, see CRS Report R41053, *Jobs for Main Street Act: Education, Training and Direct Assistance Provisions*, coordinated by Karen Spar.

<sup>44</sup> U.S. Congressional Budget Office, CBO Estimate of the Statutory Pay-As-You-Go Effects for an Amendment to the Senate Amendment to the House Amendment to the Senate Amendment to H.R. 2847, March 4, 2010, available at <http://www.cbo.gov/ftpdocs/112xx/doc11275/hr2847HPaygo.pdf>.

<sup>45</sup> U.S. Congressional Budget Office, CBO Estimate of the Statutory Pay-As-You-Go Effects for the Temporary Extension Act of 2010, As Proposed by Senator Bunning on March 2, 2010, in the nature of a substitute for H.R. 4691, March 2, 2010, available at <http://www.cbo.gov/ftpdocs/112xx/doc11268/TemporaryExtensionActof2010-Bunning.pdf>.

## Budget Baseline Projections

Given the increasing calls for attention on the country's fiscal health and in light of the current economic conditions and long term outlook, future projections of budget balance are garnering even greater attention. Due to the nature of projections, slight changes in assumptions can lead to large effects in outyear totals. Therefore, it is important to understand what projections include and assume.

CBO computes baseline projections using assumptions set out in budget enforcement legislation.<sup>46</sup> Forecasts based on these assumptions typically yield higher revenue estimates and slower growth of discretionary spending relative to scenarios independent forecasters consider likely. More specifically, CBO baseline projections incorporate three legislatively mandated assumptions: that discretionary spending remains constant in inflation-adjusted terms, that the 2001 and 2003 tax cuts fully expire after 2010 (as current law specifies), and that one-year "patches" to the alternative minimum tax (AMT) will lapse even though past Congresses have extended AMT patches year after year. However, CBO does provide projections of these costs separately from its baseline. In addition to these legislative assumptions, macroeconomic assumptions, namely the point at which CBO expects the recession to end and the speed of the recovery, will also affect the baseline estimates and projections, especially given the current economic climate.

Baseline projections showed substantial growth in receipts after 2010, when most of the tax cuts from 2001 and 2003 expire. Federal deficits are expected to grow rapidly beyond the 10-year forecast window unless major policy changes are made, however, largely because of increased outlays due to rapidly growing health care costs and baby boomer retirements.

## Budget Fiscal Year 2011

The Obama Administration released its FY2011 budget on February 1, 2010. Congress began its consideration of the FY2011 budget after receiving the President's budget request.

## Obama Administration FY2011 Budget

The Administration's FY2011 budget contains six volumes: (1) *The Budget*; (2) *Historical Tables*; (3) *Analytical Perspectives*; (4) *Appendix*; (5) *Terminations, Reductions, and Savings*; and (6) *Supplemental Materials*.<sup>47</sup> These documents lay out the Administration's projections of the fiscal outlook for the country, along with spending levels proposed for each of the federal government's departments and programs. The *Historical Tables* volume also provides significant amounts of budget data, much of which extends back to 1962 or earlier.

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<sup>46</sup> While some budget enforcement legislation constraining the computation of CBO baseline estimates has expired, CBO has continued to follow those legislative guidelines.

<sup>47</sup> The President's budget proposals can be found on the OMB website at <http://www.whitehouse.gov/omb/budget/>. The Supplemental Materials include the Federal Credit Supplement, the Object Class Analysis, the Balances of Budget Authority, and the Public Budget Database.

Consistent with the presentation of the FY2010 budget, the Obama Administration provided three separate deficit projections.<sup>48</sup> First, OMB projected a Budget Enforcement Act (BEA) baseline, using methods that mirror those CBO uses to project its current-law baseline. The BEA baseline assumes that discretionary spending remains constant in real (i.e., inflation-adjusted) terms, the 2001 and 2003 Bush Administration tax cuts expire at the end of 2010, and that the alternative minimum tax (AMT) will not be “patched.”<sup>49</sup> Many budget analysts believe such projections offer an overly rosy scenario of the long-term budget picture. Under this scenario, the FY2011 deficit is projected to total \$912 billion.

The Obama Administration also projected a Current Policy Baseline, which in its view, provides a more transparent and realistic reflection of the federal government’s current fiscal situation. They use this methodology as a base for understanding how new policy choices affect the fiscal outlook, essentially replacing the current BEA baseline. The Administration’s Current Policy Baseline assumes that the 2001 and 2003 tax cuts will be extended, that the alternative minimum tax (AMT) will be “patched” to reflect the 2009 parameter, and that certain Medicare physician payments will not be cut. This baseline also includes an adjustment for the conversion of Pell Grants from discretionary to mandatory spending. The deficit under this scenario is projected to reach \$1,145 billion in FY2011.

The final deficit projection, the Proposed Budget, illustrates the impact on the budget outlook if all of the policies of the Obama Administration are implemented. In FY2011, the Administration projects that the deficit would reach \$1,267 billion. Both the Current Policy Baseline and the Proposed Budget project deficits throughout the 10-year budget window, with deficits peaking in FY2010. Under the Proposed Budget, the deficit would fall from 8.3% of GDP in FY2011 to 3.6% of GDP by FY2018, before rising to 4.2% of GDP in FY2020.<sup>50</sup>

In his budget for FY2011, President Obama also presented a wide-ranging policy agenda. The main policy initiatives he emphasized include the creation of a fiscal commission tasked with improving the fiscal stability over the long term; other deficit reduction proposals; ongoing economic recovery; and a continuation of health care reform, clean energy, and education initiatives. In the summer, OMB will issue a *Mid-Session Review* with budget data revised to reflect changes in policy proposals, economic conditions, and other factors.

### Fiscal Commission

President Obama’s priorities included the creation of a fiscal commission tasked with balancing the budget excluding net interest payments by FY2015. (This is also referred to as a primary deficit of zero.) The commission’s recommendations would lead to annual budget deficits of roughly 3% of GDP, the projected amount of interest payments in FY2015. Obama’s proposed budget, which does not take into account any potential recommendations of the fiscal commission, recommends deficit levels averaging 4.5% of GDP over the FY2011-FY2020 period. This means that, on average, the commission would need to recommend spending decreases, tax increases, or some combination of each, totaling 1.5% of GDP. After FY2020, the

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<sup>48</sup> For details of these projections, see U.S. Office of Management and Budget, *Budget for Fiscal Year 2011, The Budget*, Tables S-1 (Proposed Budget) and S-7 (BEA Baseline and Current Policy).

<sup>49</sup> The tax cuts were enacted in the Economic Growth and Taxpayer Relief Act of 2001 (EGTRRA; P.L. 107-16) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA; P.L. 108-27).

<sup>50</sup> U.S. Office of Management and Budget, *Budget for Fiscal Year 2011, The Budget*, Tables S-1.

policy changes needed to balance the budget, excluding net interest, will likely be higher as health care costs continue to rise.

By executive order, President Obama created the 18-member commission on February 18, 2010. The commission is to comprise 12 sitting members of Congress, appointed by Senate and House leaders, and 6 additional members appointed by the President. The recommendations of the commission must be submitted to Congress by December 1, 2010, with 14 out of 18 votes needed to report recommendations.<sup>51</sup>

### ***Other Deficit Reduction Proposals***

In addition to the fiscal commission discussed above, the FY2011 President's Budget also includes other deficit reduction measures, including a freeze in non-security discretionary spending over the next three fiscal years, a fee imposed on the financial services industry over at least the next 10 years to cover the cost of TARP, and other tax proposals aimed at increasing revenue. Some of the Administration's tax proposals include closing the "carried interest" loophole, allowing lower tax rates on households earning more than \$250,000 to expire, and reforming the taxation of international income. Together, these proposals are aimed at cutting the deficit in half by the end of the President's current term.

### ***Ongoing Economic Recovery***

As the economy continues to recover, job creation, strengthening the middle class, and providing recovery assistance to rural and urban communities are top Administration priorities to restore economic growth. Education, clean energy, and infrastructure, including major investments in urban and rural communities, are targeted sectors for job creation. The Administration also specifies initiatives to provide assistance to small businesses by ensuring their access to credit and eliminating certain taxes on investments. Other specific research and development funding is also provided in the areas of science, biomedical research, and space exploration.

### ***Other Initiatives***

In its budget documents, the Obama Administration includes various proposals, including health care reform and infrastructure and education investment, similar to those in the FY2010 budget. The Administration says that health care reform is critical to economic recovery and stabilizing the federal government's long-run fiscal condition. Congress continues to consider major reforms of the health insurance and health care system, designed to expand access to health insurance and health care, to improve the quality of health care, and to slow the growth of health care costs.<sup>52</sup> The House passed the Affordable Health Care for America Act (H.R. 3962) on November 7, and the Senate passed the Patient Protection and Affordable Care Act (H.R. 3590) on December 24. Work on this legislation continues.

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<sup>51</sup> President of the United States, *Executive Order—National Commission on Fiscal Responsibility and Reform*, February 18, 2010, available at <http://www.whitehouse.gov/the-press-office/executive-order-national-commission-fiscal-responsibility-and-reform>.

<sup>52</sup> For more details, see CRS Report R40581, *Health Reform and the 111<sup>th</sup> Congress*, by Hinda Chaikind; and CRS Report R40517, *Health Care Reform: An Introduction*, coordinated by Bernadette Fernandez.

Funding for various infrastructure and energy initiatives is included as part of the President's job-creation proposals. These initiatives for a new energy economy include investing in a smart, energy-efficient, and reliable electric grid, a clean-energy future, and science research and development funding to address energy independence and climate change. Some funding for these initiatives was also contained in ARRA.

Finally, the President is proposing to increase outlays for education and training with the goal of developing a more skilled and productive labor force. Funding will be provided at both the federal level as well as via grants to state and local governments for individual programs such as Head Start and aid for higher education. Additional outlays for education and training purposes are earmarked for infrastructure investment and research and development. Funding for education-related jobs and an expansion of early childhood education programs was also provided for in ARRA.

### **Congressional Consideration of the FY2011 Budget Resolution**

The House and Senate Budget Committees began their consideration of the FY2011 budget resolution when they received the President's Budget. As part of the formulation process, the committees will receive testimony from executive branch officials, Members of Congress, and the public, and "views and estimates" statements from authorizing committees with jurisdiction over spending and revenues. The target date for completion of the budget resolution is April 15.<sup>53</sup>

## **Considerations for Congress**

Congress faces ongoing budgetary challenges in FY2011 with both short-run and long-run budget priorities that may conflict in critical ways. In the short term, economic issues may dominate policy debates, creating pressure for higher deficit spending. In the long term, increasing federal health care costs are expected to keep mandatory spending rising.

### **Short-Term Considerations**

Although economic growth returned in the third and fourth quarters of 2009, signaling a possible end to the economic recession, conditions remain weak due to budget challenges facing state and local governments, high levels of consumer debt, and continuing weakness in many real estate markets. Most economists expect unemployment rates to remain elevated for the medium term. As discussed above, Congress may choose to enact more stimulus in response to the state of the economy, which may add to the budget deficit in FY2011 and beyond.

### **General Budget Issues**

Congress may wish to consider some general budgeting issues beyond these short term considerations.

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<sup>53</sup> For more information on the congressional budget process, see CRS Report RS20368, *Overview of the Congressional Budget Process*, by Bill Heniff Jr.

## CBO Budget Documents

The Congressional Budget Office (CBO) provides data and analysis to Congress throughout the budget and appropriations process. Each January, CBO issues a *Budget and Economic Outlook* that contains current-law baseline estimates of outlays and revenues. In March, CBO typically issues an analysis of the President's budget submission with revised baseline estimates and projections. In late summer, CBO issues an updated *Budget and Economic Outlook* with new baseline projections.

In these documents, CBO sets a current-law baseline as a benchmark to evaluate whether legislative proposals would increase or decrease outlays and revenue collection. Baseline estimates are not intended to predict likely future outcomes, but to show what spending and revenues would be if current law remained in effect. CBO typically evaluates the budgetary consequences of legislative proposals and the Joint Committee on Taxation (JCT) evaluates the consequences of revenue proposals.

CBO also releases other periodic publications focusing on the future fiscal health of the United States. In their publication, *The Long-Term Budget Outlook*, CBO makes projections on the state of the federal budget to FY2083. They discuss spending and revenue levels and the related issues that they expect will arise under different policy assumptions. In their *Budget Options* volumes, they provide specific policy options and the impact they will have on spending and revenues over a 10-year budget window. They also provide arguments for and against enacting each policy.

## Budget Transparency

The budget, reflecting the size and complexity of the federal government, is complicated and detailed. The budget books that OMB compiles provide an enormous amount of information, and other budget data reported by federal agencies provide even more detail on federal spending plans. The Federal Funding Accountability and Transparency Act of 2006 (P.L. 109-282) included several measures to increase the accessibility of budget information. For example, as a result of that act, OMB now runs the USA Spending.gov website, which provides detailed information on federal spending. Some, however, have raised concerns about the quality of those data.<sup>54</sup> Moreover, it is not clear that those data are thoroughly coordinated with other federal budgeting data systems.

Congress and the President have undertaken additional efforts in an attempt to improve transparency in light of the large amounts of spending currently occurring as a result of economic stabilization efforts and federal financial interventions. Websites, such as Recovery.gov, were launched to track stimulus spending. The Congressional Oversight Panel was established in the Emergency Economic Stabilization Act to oversee TARP spending. Despite this, criticisms remain and requests for greater transparency continue.

In certain cases, despite the large amount of data provided by OMB and other government agencies, it can be difficult to answer relatively simple budget questions. Critics maintain that the federal government in general and OMB in particular should take steps to make data on federal spending even more transparent to taxpayers and more useful to policymakers. Even as the

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<sup>54</sup> For more information, see CRS Report RL34718, *The Federal Funding Accountability and Transparency Act: Implementation and Proposed Amendments*, by Garrett Hatch.

President's budget mentions "a new tracking tool" to provide daily updates on spending by agency, Congress wants to consider requiring these changes to provide more organized and transparent budget data to citizens and to itself.<sup>55</sup>

## Budget Enforcement Measures

The Budget Enforcement Act and other budget enforcement legislation was widely credited for laying the groundwork for the federal government's surpluses between FY1998-FY2001. One of the components of this group of legislation, statutory PAYGO, which effectively was terminated in December 2002, discouraged the enactment of new mandatory spending and revenue legislation that is not deficit neutral (i.e., legislation that would cause, or increase, a deficit or reduce a surplus) due to the threat of sequestration.<sup>56</sup> President Obama's budget included various proposals for budget process reform; perhaps the most significant proposal from the perspective of budget enforcement was a proposal to reinstate statutory PAYGO procedures.<sup>57</sup> In February 2010, the House and Senate once again enacted statutory PAYGO, similar to what was in effect in the 1990s and early 2000s (Title I of P.L. 111-139). While PAYGO procedures do not facilitate reducing existing deficit levels, they may help to keep deficit levels from increasing due to legislative action. Critics note, however, that the new statutory PAYGO procedures allow for the enactment of legislation in several "current policy" areas that could boost deficit levels significantly.<sup>58</sup>

## Long-Term Considerations

Annual budget deficits or surpluses are not always the best indication of long-term fiscal stability. Most economists agree that, under certain conditions, running a budget deficit may be necessary to provide economic stimulus or pull an economy out of recession. A large budget deficit in a single year, in itself, does not necessarily indicate a longer-term problem. The federal government, however, faces serious long-term budget challenges. Some measures of fiscal solvency in the long term indicate that, under current policy, the U.S. may face a major future crisis, specifically as it relates to rising health care costs and the likely impact on government-financed health care spending.

CBO, GAO, and the Administration agree that the current mix of federal fiscal policies is unsustainable in the long term. The nation's aging population, combined with rising health care costs per beneficiary, seems likely to keep federal health costs rising faster than per capita GDP. CBO projected in June 2009 that under current policy, federal spending on Medicare and Medicaid would grow from 5% of GDP today to about 10% of GDP in 2035, and to more than 17% by 2080.<sup>59</sup> The 2010 Economic Report of the President also called the trajectory of future

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<sup>55</sup> U.S. Office of Management and Budget, *Budget for Fiscal Year 2011, The Budget*, p. 44.

<sup>56</sup> See CRS Report RL34300, *Pay-As-You-Go Procedures for Budget Enforcement*, by Robert Keith.

<sup>57</sup> Office of Management and Budget, *Budget of the United States Government, Fiscal Year 2011, Analytical Perspectives*, Feb. 1, 2009 (see Chapter 13, "Budget Process," pp. 143-155).

<sup>58</sup> The PAYGO legislation enacted by the House and Senate exempts the extension of certain spending and revenue measures, including a five-year fix to scheduled cuts to Medicare physician reimbursement rates, a two-year fix to prevent the Alternative Minimum Tax from hitting more taxpayers and to restore the Estate Tax to 2009 rates and exemptions, and a permanent extension of middle-class tax cuts.

<sup>59</sup> U.S. Congressional Budget Office, *The Long-Term Budget Outlook*, June 2009, pp. 9.

federal spending on Medicare and Medicaid unsustainable.<sup>60</sup> Finally, GAO's recent long-term fiscal simulations, under an alternative policy scenario, projected debt held by the public as a share of GDP to exceed the post World War II historical high in about 10 years.<sup>61</sup>

Keeping future federal outlays at 20% of GDP, approximately its current share, and leaving fiscal policies unchanged, according to CBO projections, would require drastic reductions in all spending other than that for Medicare, Social Security, and Medicaid, or reigning in the costs of these programs. Under the extension of current policy, CBO estimates that the nation's current fiscal gap, a present-value measure of fiscal imbalance for a given time period, would reach 3.2% of GDP over the next 75 years. This means that an immediate and permanent reduction in spending, increase in revenues, or a combination of spending cuts and revenue increases amounting to 3.2% of GDP would be needed to make the government's debt the same size (relative to the size of the economy) at the end of that period as it was at the beginning. Under an alternative fiscal scenario, which incorporates some policy changes that are widely expected to occur and that policymakers have regularly made in the past, the fiscal gap reaches 8.1% of GDP.<sup>62</sup> This indicates that an immediate and permanent reduction in spending, increase in revenues, or a combination of spending cuts and revenue increases amounting to 8.1% of GDP would be needed to make the government's debt the same size (relative to the size of the economy) at the end of that period as it was at the beginning.<sup>63</sup>

Enacting policies to close the fiscal gap under either scenario would likely require significant changes in major entitlement programs. The President's FY2011 budget included health care as one of its policy initiatives to improve the country's long-term fiscal outlook. It recommends funding for various proposals aimed at health care cost containment, such as enhanced health IT policy and the expansion of affordable primary and preventive care for underserved populations.<sup>64</sup> CBO concurs that the threats to the long-term budget outlook are largely due to the rising costs of healthcare and these problems cannot be solved without controlling these costs. However, there are difficult tradeoffs in expanding insurance coverage while making major changes in the financing or provision of health insurance and health care.<sup>65</sup>

As the economic recovery continues, Congress may focus more effort on balancing the budget and reining in the debt. This would require less spending, increases in revenue collections, faster-than-average economic growth, or a combination of these things. Many economists agree that having some federal debt is a good thing because it builds credit which allows for more favorable borrowing terms. It encourages investment within the country because federal debt is seen as relatively low-risk and safe. Debt is not free, however, and requires interest payments that can strain budgets if debt levels and interest rates are high. High debt levels could limit the government's flexibility in meeting its obligations or in responding to emerging needs of its

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<sup>60</sup> Council of Economic Advisors, *Economic Report of the President*, February 2010, pp.140.

<sup>61</sup> Government Accountability Office, *The Federal Government's Long-Term Fiscal Outlook: Fall 2009 Update* (GAO-10-137SP), October 15, 2009, pp.1.

<sup>62</sup> The alternative fiscal scenario includes things like the extension of certain expiring tax provisions, the continued indexation of AMT to inflation, and Medicare physician payment rates growing with the Medicare economic index. For a complete description of the assumptions included in the extended baseline and alternative fiscal scenarios, see U.S. Congressional Budget Office, *The Long-Term Budget Outlook*, June 2009, Table 1-1.

<sup>63</sup> U.S. Congressional Budget Office, *The Long-Term Budget Outlook*, June 2009, Box 1-1.

<sup>64</sup> U.S. Office of Management and Budget, *Budget for Fiscal Year 2011, The Budget*, pp. 30-32.

<sup>65</sup> U.S. Congressional Budget Office, *Key Issues in Analyzing Major Health Insurance Proposals*, December 2008, pp. ix-x.

citizens. Ultimately, failing to take action to reduce the projected growth in the debt potentially might lead to future insolvency or government default.<sup>66</sup>

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<sup>66</sup> Recent trends in the credit default swap market imply an increased, albeit still small, market perception of the likelihood of default on certain Treasury securities. In past years, Treasury securities were typically regarded as risk-free. See Alan Auerbach and William Gale, “The Economic Crisis and the Fiscal Crisis: 2009 and Beyond: An Update,” Tax Policy Center working paper, September 2009, available at [http://www.brookings.edu/~media/Files/rc/papers/2009/06\\_fiscal\\_crisis\\_gale/06\\_fiscal\\_crisis\\_gale\\_update.pdf](http://www.brookings.edu/~media/Files/rc/papers/2009/06_fiscal_crisis_gale/06_fiscal_crisis_gale_update.pdf).